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September 4, 2008

Mike N. Williams, A.A.E. - Director

Department of Airports

825 East Third Street, Room 203

San Bernardino, CA 92415-0831

SUBJECT: DEPARTMENT REQUESTED SECURITY DEPOSITS REVIEW

Introductory Remarks

This review was requested by the newly appointed Director of Airports. In compliance with Article V, Section 6, of the San Bernardino County Charter, the Board of Supervisor's Policy Statement on Internal Operational Auditing and the Standard Practice for Cash and Internal Controls, we have completed a review of the security deposit trust fund maintained by the Department of Airports. Our audit was conducted in accordance with the standards developed by the American Institute of Certified Public Accountants Consulting Services.

Background

The Department of Airports (Department) is comprised of six airports located throughout San Bernardino. These airports include Chino Airport, Apple Valley Airport, Barstow-Daggett Airport, Twenty-nine Palms Airport, Needles Airport and Baker Airport. The Department currently manages more than 400 leases for purposes ranging from aircraft parking to major aviation developments. Depending on the nature of the lease agreement, the Real Estate Services Department also provides assistance with the management of the Airports' leases.

Scope of Audit

Our objective was to determine whether the cash handling and security deposit record procedures practiced are effective.

We accomplished our objectives by performing the following procedures:

- We reviewed a sample of active leases and the supporting documents in the customer lease files, including the lease agreements.
- We reviewed a sample of inactive leases for the proper disbursement of the security deposit.

- We interviewed Airport personnel regarding the management of the security deposit records.

Overall Conclusion

We have concluded that the cash handling and security deposit records procedures need to be improved. The improvements needed were specifically related to:

- Overall cash control safeguards
- Management oversight procedures
- Effective management of customer leases

Findings and Recommendations

The specific policies, procedures, and practices that need improvement are discussed below.

Audit Finding #1 **Management has not established written policies and procedures for the operations of the department.**

The premise of an effective internal control structure is the department's Control Environment, which includes such elements as management's philosophy and operating style and personnel policies and practices. It is imperative that management establishes internal controls, such as policies and procedures, and communicates them to the operating personnel. Implementing internal controls would increase the assurance that management's financial policies and objectives are both followed and achieved. In addition, management should monitor these controls to ensure they are working as intended and to help detect errors and irregularities.

During the course of our audit, we identified the following conditions:

- Procedure manuals currently in place are incomplete, outdated and in some cases obsolete.
- The department's practice is to communicate procedures verbally. Therefore, we could not verify if the fiscal practices conducted by the Staff Analyst II and the operating personnel she directs conflict with the direction of the director that recently resigned.
- The department does not have official policies and procedures related to the fiscal aspects of operations that would provide guidance to employees, establish authority, and define internal controls for the department.
- The work routinely performed by operating personnel (e.g., monthly reconciliations) is not being formally reviewed by management, as the staff has no written policies instructing them to submit their work for management review.

Without establishing and communicating fiscal policies and procedures that establish guidelines, authority and controls, the risk of the department not achieving its financial objectives and the risk of cash being misappropriated increases.

Recommendation

Management should develop, implement and communicate official policies and procedures approved by the department head to provide guidelines, establish authority and implement controls for the department.

Management Response

We concur with audit findings and will resolve the deficiency as follows:

The Department of Airports is currently developing written procedures for the lines of business activities for which it conducts and is responsible to complete. Administrative and fiscal authorities, duties and responsibilities will be clearly defined. The department of Airports anticipates that this document will be completed by July 1, 2009.

Additionally, the Department of Airports would like to work cooperatively with the Auditor/Controller-Recorder in the development of these departmental procedures.

Auditor Response

Management's response addresses planned actions to correct deficiencies noted in the audit finding.

Audit Finding #2 Lack of proper segregation of duties amongst the operating personnel.

Segregation of duties are designed to reduce the opportunities for a person to be in position to perpetrate and conceal errors and frauds when performing normal duties. A strong internal control environment is demonstrated by the segregation of responsibilities for authorizing transactions, physical custody of assets and the related record keeping.

The responsibilities of the Staff Analyst II include authorizing transactions, maintaining custody of check receipts, and managing the billing system and security deposit log. These job functions conflicted and need to be performed separately by other staff members.

The staffing limitations that exist within the department are the primary cause of operating personnel performing conflicting duties. Improper segregation of duties may allow internal controls to be compromised to conceal unintentional errors or fraud.

Recommendation

Management should segregate the functions of recording lease activity, authorizing transactions, and maintaining custody check receipts. The security deposit log should be password protected and made available as a read-only file for staff involved in the payment posting and deposit process. If staffing limitations hinder the segregation of these functions, then management should implement mitigating controls to reduce the risk of unintentional errors and fraudulent financial reporting, such as reviewing the work performed by the operating staff on monthly basis.

Management Response

We concur with audit findings and will resolve the deficiency as follows:

An access password has been added to the security deposit log, reflecting read-only access for staff involved in payment posting and deposit processes.

The Director of Airports and/or the Assistant Director are reviewing various fiscal activities on a monthly basis.

The Department of Airports is currently developing written procedures for the lines of business activities for which it conducts and is responsible to complete. Administrative and fiscal authorities, duties and responsibilities will be clearly defined. The department of Airports anticipates that this document will be completed by July 1, 2009.

Additionally, the Department of Airports would like to work cooperatively with the Auditor/Controller-Recorder in the development of these departmental procedures.

Auditor Response

Management's response addresses planned actions, as well as actions taken to correct deficiencies noted in the audit finding.

Audit Finding #3 The process of initiating, maintaining, and terminating customer leases needs to be improved.

The County's Internal Control and Cash Manual (ICCM), Chapter 13, states that records are to be maintained to account for all receipts and disbursements from the trust fund. Also, good business practices are demonstrated when the department accurately documents the lease information in the customer records.

Our review of customer leases disclosed the following discrepancies:

- The department neglected to collect a security deposit from the customer when the terms of the lease agreement required a deposit to be paid.

- Security deposits were neither being recorded on the Trust Log (security deposits listing) or on the check log to indicate that a security deposit was paid by the customer.
- The lease numbers assigned to the lease agreements were not correct, which made the audit trail of both the active and terminated lease agreements ineffective.
- A copy of the Trust Log was not maintained with the monthly FAS reconciliation.

Operating personnel was not consistently adhering to the stipulations of the customer lease agreements. The trust fund will be financially misrepresented and the audit trail of the lease agreements will continue to be ineffective if operating personnel continues to be inconsistent with adhering to the protocol of initiating, maintaining, and terminating lease agreements.

Recommendation

Management should ensure that operating personnel is adhering to the requirements of the ICCM by routinely reviewing work that they perform. Management needs to document their review of the monthly reconciliation of the Trust Log and FAS report. Furthermore, a copy of the Trust Log that was used to perform the reconciliation needs to be maintained with the monthly FAS report.

Management Response

We concur with audit findings and will resolve the deficiency as follows:

The Department of Airports is currently developing written procedures for the lines of business activities for which it conducts and is responsible to complete. Administrative and fiscal authorities, duties and responsibilities will be clearly defined. The department of Airports anticipates that this document will be completed by July 1, 2009.

Additionally, the Department of Airports would like to work cooperatively with the Auditor/Controller-Recorder in the development of these departmental procedures.

As an interim measure, the Department is performing a reconciliation of the Trust Log and FAS report on a monthly basis. The results of this reconciliation will be reviewed by the Director of Airports or his designated alternate.

Auditor Response

Management's response addresses planned actions, as well as actions taken to correct deficiencies noted in the audit finding.

Audit Finding #4 **A reconciliation of the Trust Log and the Aeroware billing report is not being performed on a monthly basis.**

A good internal control environment is evidenced by practicing controls that safeguard assets and prevent and detect errors and fraud.

The Trust Log and the Aeroware billing report indicated a difference in the total security deposit amounts. During the course of our audit, we noted the following:

- On June 3, 2008, the total security deposits listed on the Trust Log and Aeroware report was \$243,424.37 and \$135,077.63, respectively, resulting in a variance of \$108,346.74.
- On July 10, 2008, the total security deposits listed on the Trust Log and Aeroware report was \$245,018.47 and \$210,165.90, respectively, resulting in a variance of \$34,852.57.

The department is not performing a monthly reconciliation of the Trust Log and the Aeroware billing report to ensure the month-end security deposit total recorded is accurate. The security deposit information may not be properly recorded on the Trust Log and in the Aeroware billing system. Consequently, any report produced at month-end will not accurately reflect the customer's security deposit information.

Recommendation

The department needs to perform a reconciliation of the Trust Log and the Aeroware billing report on a monthly basis. Management should take appropriate corrective action to resolve any identified variances between the reporting systems. In addition, management should document their review of the monthly reconciliation.

Management Response

We concur with audit findings and will resolve the deficiency as follows:

The Department of Airports is currently developing written procedures for the lines of business activities for which it conducts and is responsible to complete. Administrative and fiscal authorities, duties and responsibilities will be clearly defined. The department of Airports anticipates that this document will be completed by July 1, 2009.

Additionally, the Department of Airports would like to work cooperatively with the Auditor/Controller-Recorder in the development of these departmental procedures.

As an interim measure, the Department is performing a reconciliation of the Trust Log and Aeroware billing report on a monthly basis. The results of this reconciliation will be reviewed by the Director of Airports or his designated alternate.

The Department of Airports is a fairly small department within the County and does not have access to significant revenue streams. In light of the current economic conditions within the County and the national aviation economy, adding additional staff to implement the recommendations in this report will be challenging. The Department of Airports appreciates the insight provided by the Auditor/Controller-Recorder, however, it will be necessary to work cooperatively in implementing these recommendations in light of the current economic climate.

Auditor Response

Management's response addresses planned actions, as well as actions taken to correct deficiencies noted in the audit finding.

We would like to express our appreciation to the staff at the Department of Airports for their support and cooperation during the engagement.

Respectfully submitted,

Larry Walker
Auditor/Controller-Recorder

By: _____
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